United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76-6188

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P/S

United States Court of Appeals

For The Second Circuit

UNITED STATES OF AMERICA and ROBERT RAGONE, Special Agent, Internal Revenue Service,

Petitioners-Appellees,

vs.

MANUFACTURERS & TRADERS BANK, (formerly First Empire Bank—New York) and JAMES A. KYPRIOS, Vice President, International Banking, Manufacturers & Traders Bank,

Respondents,

ALLAN H. APPLESTEIN,

Proposed Intervenor-Appellant.

On Appeal from the United States District Court, Southern District of New York

BRIEF FOR APPELLANT

BALLON, STOLL & ITZLER
Attorneys for Appellant
1180 Avenue of the Americas
New York, New York 10036
(212) 575-7900

(10318) LUTZ APPELLATE PRINTERS, INC.
Law and Financial Printing
South River, N.J. (201) 257-6850 | New York, N.Y. (212) 563-2121 | Philadelphia, Pa. (215) 563-5587 | Washington, D.C. (201) 783-7288

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STATEMENT OF THE ISSUES

1. Were the undisputed facts submitted to the Court below sufficient to establish an abuse by Internal Revenue Service of its power to issue a summons?

2. Did the undisputed facts submitted below create a sufficient question as to the propriety of the use by Internal

Revenue Service of its summons power so as to warrant further inquiry into the purpose for which such summons was issued?

3. Should appellant be permitted to intervene in this enforcement proceeding in order to challenge the use of the power of the Internal Revenue Service to issue this summons?

STATEMENT OF THE CASE

This is an appeal from an order of the United States District Court, Hon. Charles M. Metzner, denying appellant's application to intervene in a proceeding by appellees to enforce an Internal Revenue Service Summons ("Summons") issued to respondent bank requiring the production of records of the bank's dealings with appellant during the years 1971, 1972, 1973 and 1974.

The summons was issued on February 10, 1976.

On March 30, 1976, on appellant's application, an order was entered by United States District Judge Charles M. Metzner preliminarily enjoining the bank from complying with the summons.

On October 5, 1976, appellees commenced this proceeding pursuant to 26 U.S.C. §§7402(b) and 7604(a) to compel the bank to honor the summons.

Appellant moved by order to show cause returnable October 20, 1976, to intervene in that proceeding for the purpose of contesting the validity of the summons.

Appellant's application was denied by Hon. Charles M. Metzner on November 22, 1976.

On November 25, 1976 appellant filed a notice of appeal to this Court.

STATEMENT OF THE FACTS

In September 1974, Milton Billig, a regular agent of the Internal Revenue Service ("IRS"), assigned to the Miami, Florida office, commenced a civil audit of the tax returns of appellant and certain corporations with which he was affiliated, for the calendar years 1971, 1972 and 1973 (55a). From September, 1974 until April, 1975, Billig made numerous visits to the offices of James R. Kaufman, appellant's accountant to examine records (55a).

By April, 1975, Billig had completed the field audit and advised the accountant that he would meet with him in the future to discuss proposals (55a). Kaufman understood that the audit was completed and a final report would be forthcoming shortly (55a).

Approximately one month thereafter, during a chance encounter, Agent Billig advised Kaufman that by reason of a substantial work load, the final report would not be forthcoming for some time (55a).

No final report was ever received. Instead, on June 3, 1975, Richard E. Jaffee, a Special Agent of IRS sent a notice to appellant advising him that IRS had commenced an investigation to determine whether appellant had committed *criminal* violations of the tax laws (41a). On June 9, 1975, a similar notice was sent to appellant by Agent Jaffee advising that a similar criminal investigation had been commenced of the Allan Applestein Foundation Trust (42a). Neither notice referred to a civil or joint investigation or to the question of civil liability.

In fact, from April, 1975 to the present, appellant never heard another word about the civil audit. The reason for that is quite simple. By memorandums dated November 25, 1975 and August 25, 1976, the District Director specifically requested the

Audit Division to take no civil assessment action until the Intelligence Division had completed its investigation and made a recommendation concerning prosecution (23a).

Nothing further happened until the issuance of the summons on February 10, 1976 and its service on the bank on February 25, 1976. When appellant learned of the summons he communicated with Philip Weinstein, Esq., an attorney in Miami, Florida. Weinstein called Special Agent Ragone, one of the appellees, at the New York office of IRS and inquired about the summons (50). Ragone advised that it had been issued at the request of special agents in Miami who were conducting a criminal investigation (51a).

Weinstein stated in an affidavit that in response to a specific question, Ragone answered that the investigation was "strictly criminal" (51a). Weinstein's statement to this effect was corroborated by the affidavit of another attorney, Alan L. Weisberg who participated in the conversation on an extension telephone (52a).

Agent Ragone, in reply, stated that he did not say that the investigation was strictly criminal but merely that his functions as a special agent were strictly criminal (60a, 61a), hardly a startling piece of information to an attorney admitted to practice in the United States Tax Court (49a).

Based upon the foregoing facts, appellant moved to intervene in the proceedings before Judge Metzner to enforce the summons. Appellant contended that the summons was being improperly used in aid of a criminal investigation or at least that there was a sufficient indication of such a purpose to warrant discovery proceedings to determine the purpose for which the summons was issued.

Appellees submitted several affidavits in response which, despite numerous protestations that the investigation is a joint civil-criminal investigation, never really denied that, at present,

it is exclusively criminal. Indeed, reading the affidavits carefully, one realizes that, in fact, they have admitted the criminal nature of the investigation. Moreover, even though the various affiants could have easily attested to the fact, if it were true, not one statement appears which states that evidence is being sought for the purpose of determining appellant's tax liability or effecting collection thereof, or any other legitimate purpose of a summons. More important, not once is there a reference in any affidavit to the identity of any facts or areas of facts being sought in connection with the civil audit. The most anyone was able to say was that the facts unearthed might be of use in determining and computing civil *fraud* penalties (66a).

Revenue Agent Billig, for example, after quoting from the accountant's affidavit which stated that Billig had completed the field audit and had advised that he would meet the accountant in [illegible] future to discuss proposals, does not deny any of those [illegible] ents. He merely states that the accountant was not jus[illegible]i in concluding, as a result, that the investigative phase of the c[illegible]l audit was completed (66a).

Significantly, Billig fails to stated in what respects the civil audit remained uncompleted or even unequivocally that it was not completed (66a, 67a). He states merely that the results of the criminal investigation will be used in considering the assertion of fraud penalties (66a).

The affidavit of Special Agent Grant, however, is much more revealing. He says that as a consequence of the memos advising the Audit Division to take no civil assessment action, he is now the primary agent (23a). In other words, he, the criminal investigator will now direct the investigation. Then he says:

> "Upon completion of my aspect of the investigation, a determination of whether or not

> criminal prosecution should be recommended will be made.
>
> * * *
>
> If no criminal prosecution is recommended, the audit division will continue its active investigation using, among other things, the information developed by me and other agents in the Intelligence Division." (23a, 24a).

Despite these facts which make it clear that the civil investigation was either completed or suspended pending completion of the criminal investigation, the District Court denied appellant's application to intervene and directed compliance with the summons. The only factual conclusions used by the Court as a basis for its decision were that no recommendation had yet been made for criminal prosecution and the investigation is *likely* to lead to civil liability as well as criminal prosecution (70a).

ARGUMENT

I.

The issuance of the summons was an abuse of power by the Internal Revenue Service.

Before considering whether or not appellant is the appropriate person to raise the issue, this Court must first determine whether IRS had the authority to issue the Summons.

An examination of the record indicates clearly that it did not. The Summons was issued in aid of a criminal investigation. Such a purpose is not authorized. The reliance by the appellees and the Court below on the fact that prosecution had not yet been recommended, as support for a determination that the Summons was statutorily authorized, is not warranted.

The authority for the issuance of the Summons derives from Title 16 United States Code, §7602 which provides that such a summons may be issued:

> "For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting of any such liability . . . ."

Despite its attempt to avoid the issue by asserting over and over that the Summons was issued in connection with a joint civil-criminal investigation, the government does not even attempt to argue that any one of the specified purposes is involved in this phase of the investigation.

Calling the investigation a joint civil-criminal one merely begs the question. IRS in the numerous affidavits submitted by it had more than ample opportunity to set forth, even in general terms, the statutorily authorized purpose for which it had issued the Summons. Instead, with commendable candor, Special Agent Robert Grant conceded that the Audit Division had been requested to take no further action and that he, as the primary agent would now conduct the investigation for the purpose of determining whether or not criminal prosecution should be recommended (23a). Not until such a determination was made would the Audit Division continue its civil phase of the investigation, and then only if criminal prosecution was not recommended (24a).

There can be no doubt, therefore, that the Summons was issued in connection with Agent Grant's investigation to determine whether or not criminal prosecution should be recommended. If this is not a criminal investigation, then it is

impossible to understand what does constitute a criminal investigation in the opinion of IRS. The fact that it is characterized by IRS as a joint civil-criminal investigation does not change its nature any more than does the fact that information uncovered may be used to assist in the civil audit if no criminal prosecution is involved.

Appellees, however, assert that even if the investigation has no civil audit purpose, the issuance of the Summons is proper unless the sole object of the investigation is to gather data for criminal purposes, which, they say cannot be the case unless a determination has been made to prosecute. They rely, for this conclusion, on certain out-of-context language in *Donaldson v. United States*, 400 U.S. 517 (1971).

A careful reading, however, of *Donaldson, supra*, and its progenitor, *Reisman v. Caplin*, 375 U.S. 440 (1964) makes it clear that such an interpretation is not justified.

In *Reisman*, the Court stated that a summons could be challenged on the ground that "the material is sought for the improper purpose of obtaining evidence for use in a criminal prosecution" (p. 449).

In *Donaldson*, the Court, referring to that language of *Reisman* interpreted it as relating to a criminal prosecution pending at the time a summons is issued or ". . . at most, . . . an investigation solely for criminal purposes" (p. 583).

Using that test, the Court in *Donaldson*, determined that the summons had not been improperly used. But that was because in the *Donaldson* case, a civil investigation was clearly being conducted simultaneously with a criminal investigation. According to the affidavits of the agents, they were conducting "'. . . an investigation for the purpose of ascertaining the correct income tax liability' of the taxpayer for the years 1964-1967, inclusive, and that it was 'necessary' to examine the records and

to take the testimony requested in order to ascertain the taxpayer's correct income tax liability for those years." *(Donaldson,* p. 520).

On the basis of such facts the Court obviously concluded that a civil and criminal investigation were proceeding simultaneously, which was proper, and that under such circumstances, "their combined efforts are directed to both civil and criminal infractions" (p. 535). The Court thus felt that the possibility that the taxpayer ". . . might be indicted and prosecuted was only a possibility, no more and no less in his case than in the case of any other taxpayer whose income tax return is undergoing audit." (p. 534). Where both civil and criminal aspects of a taxpayer's return are undergoing examination, the Court found ". . . no statutory suggestion for any meaningful line of distinction, for civil as compared with criminal purposes, at the point of a special agent's appearance." (p. 535). The Court thus concluded that "To draw a line where a special agent appears would require the Service, in a situation of suspected but undetermined fraud, to forego either the use of the summons or the potentiality of an ultimate recommendation for prosecution." (p. 535, 536).

It was by virtue of this process of reasoning that the Court in the last sentence of its opinion set forth the guiding principal that a ". . . summons may be issued in aid of an investigation if it is issued in good faith *and* prior to a recommendation for criminal prosecution." (Italics supplied).

It would seem obvious therefore that the mere fact that a summons is issued prior to a recommendation for prosecution was not deemed sufficient by the Supreme Court to make it a proper use of the power of IRS to issue summonses. The summons must also be issued in good faith.

Under what circumstances can it be said that a summons issued prior to a recommendation for prosecution is not issued in good faith? A summons is not issued in good faith, even if

prior to a recommendation for prosecution, if the sole purpose of the summons is to obtain evidence of a violation of criminal law so as to support a recommendation for prosecution. A summons is issued in bad faith if it is not in any way related to a determination of the correctness of a return or the determination of tax liability or any other purpose specified by statute.

A summons is issued in bad faith where, as in this case, the civil audit procedure has been terminated until the criminal aspects of the investigation have been completed (see affidavit of Special Agent Grant). A summons is not issued in good faith merely because IRS agents call the investigation a joint civil-criminal investigation where the civil aspect of that investigation has been placed in suspense.

This understanding of the meaning of the *Donaldson* decision is shared by the District of Columbia circuit in *United States v. Wall Corp.*, 475 F.2d 893 (1972) where the Court stated at page 895:

> ". . . Donaldson also required that a summons be issued 'in good faith.' Thus, if it can be shown that the investigation agent had already formed a firm purpose to recommend criminal prosecution even though he has not as yet made a formal recommendation, issuance of the summons would presumably be in bad faith. Similarly, if the civil liability were already determined, the summons would appear to be solely for a criminal purpose."

Discovery in this case would very likely lead to a determination that the agents have already formed a firm purpose to recommend criminal prosecution since all of the agents despite their presumed familiarity with the *Wall Corp.* case, *supra,* studiously refrained from denying the existence of such a state of mind. However, even if such a mental process has

not yet been completed, the fact that this investigation has only one focus, *i.e.*, to determine whether or not criminal prosecution should be recommended is sufficient to cause this Court to find that the summons was not issued in good faith and hence is not enforceable.

Another case which supports appellant's understanding of the meaning of *Donaldson* is *United States v. McCarthy*, 514 F.2d 368 (3rd Cir. 1975). In that case, which quoted with approval from *United States v. Wall Corp., supra*, the Court, even in the face of allegations by the agents that the materials sought were necessary to ascertain taxpayer's correct tax liability, held that defendant's allegations that the investigation was being conducted by a special agent in the Intelligence Division and allegations that the taxpayer's civil liability for the years in question had already been determined, were sufficient to raise an issue requiring a hearing. The allegations, the Court said, "sufficiently raise the possibility that the IRS agents charged with the investigation of defendant corporation had no intention of pursuing any civil remedies as to bring into question their good faith." See also *United States v. Lafko*, 520 F.2d 622 (3rd Cir. 1975).

How much clearer is our case, where the special agent has clearly stated that "Upon completion of [his] aspect of the investigation a determination of whether or not criminal prosecution should be recommended will be made." (23a). Only if no criminal prosecution is recommended will the Audit Division continue its civil investigation (24a).

There is clearly no civil purpose to be served by this summons. It is issued in bad faith and should not be enforced.

II.

The undisputed facts are sufficient to warrant further inquiry into the purposes for which the summons was issued.

If this Court should determine that the facts as they appear from the affidavits below are not sufficient to warrant the conclusion that the sole purpose of the Summons is to obtain evidence for use in a criminal prosecution, then appellant argues that, at the very least, a hearing is required to establish the real purpose of the summons.

The appellees have attempted to satisfy this Court with respect to the purpose of the summons by constant repetition of the statement that the investigation is a joint civil-criminal one. Yet they have carefully avoided every opportunity to set forth, even in the most general terms, the nature of the civil aspects of the investigation. They did not even specifically deny the statements of appellant's accountant that the field audit had been completed and that only a final report remained to be done. Instead, Revenue Agent Billig attempted to finesse the issue with the statement that the accountant was not justified in drawing a conclusion that the civil audit had been completed (66a). The government owes a greater obligation of candor to its citizens than that. The failure of the appellees to explain the civil phase of this investigation coupled with Special Agent Grant's statements that the Audit Division had been instructed to take no further action until he had determined whether or not to recommend criminal prosecution, certainly, at the least, create very strong inferences that this is a criminal investigation. Under such circumstances, justice requires that a hearing be held for the purpose of examining further into the purposes for which this summons was issued.

The United States Court of Appeals for the Fifth Circuit clearly recognized this right in cases decided both before and after the decision of the Supreme Court in *Donaldson, supra;*

see *United States v. Roundtree*, 420 F.2d 845 (1969) and *United States v. Wright Motor Co.*, 76, 2 U.S.T.C. 9605 (1976).

Indeed, the appellees in their memorandum in opposition to appellant's application to intervene did not seriously dispute the right of a taxpayer to discovery in a proper case although they urged that such discovery should be limited.

Appellant strongly contends that this is a proper case and assures this Court that he seeks only sufficient discovery to enable the Court to determine the true purpose of the Summons, a purpose heretofore successfully concealed by the appellees' rather vague general statements.

In *United States v. McCarthy*, 514 F.2d 368 (3rd Cir. 1975), the Court in a similar, but not so strong, case required a hearing on allegations that a summons was not issued in good faith. In the *McCarthy* case, the taxpayer was relying on the fact that IRS had conducted a previous examination of the years in question and on the fact that a special agent was assigned to the investigation. The Court held that these two facts, standing alone, did not justify a conclusion that there were no civil aspects to the investigation. The Court did find, however, ". . . that these allegations, although not very strong, sufficiently raise the possibility that the IRS agents charged with the investigation of defendant corporation had no intention of pursuing any civil remedies as to bring into question their good faith" (p. 375).

It should be noted that in the *McCarthy* case the agents specifically asserted that the materials sought were necessary to ascertain the correct tax liability of the taxpayer. Such an assertion is remarkably absent in this case creating more than ample justification for further inquiry into the true purpose behind the issuance of the Summons by such reluctant agents.

III.

If the summons was or might have been issued in bad faith, appellant should be permitted to intervene to challenge it.

The right of a taxpayer to intervene in a proceeding to enforce an Internal Revenue Service summons was recognized by the Supreme Court in *Reisman v. Caplin*, 375 U.S. 440 (1964).

The Court in *Donaldson, supra,* interpreted the opinion in *Reisman* to mean that intervention was permissive not mandatory. The Court then found that *Reisman* specified two instances where intervention was appropriate, one of them being ". . . where 'the material is sought for the improper purpose of obtaining evidence for use in a criminal prosecution'". (p. 530).

The Court concluded that "The usual process of balancing opposing equities is called for" (p. 530).

From this language, the appellees would seek to draw the conclusion that a District Court has virtually unlimited power to grant or deny intervention in its discretion with virtually no review possible except in the case of a clear abuse of that discretion.

Appellant contends that the balancing of equities referred to by the Supreme Court placed a more substantial obligation on the courts. Where, as here, the record strongly implies if it does not, in fact, clearly establish an abuse of process, permissive intervention becomes virtually mandatory. A failure to grant such intervention becomes a clear abuse of discretion. No other approach can properly balance the equities. There are no equities in the appellees' position. They could easily have allayed all suspicion with a brief description of the nature of the civil investigation. They did not. Whether by choice or because they could not is immaterial.

Equity demands that appellant, the taxpayer, the only person whose interest is really involved, be allowed to intervene to challenge appellees' abuse of power.

The Congress of the United States has recognized that right by enacting Section 1205 of the 1976 Tax Reform Act which grants an absolute right of intervention.

This Court should do no less.

Respectfully submitted,

BALLON, STOLL & ITZLER
Attorneys for Appellant

Morton S. Robson
Of Counsel

A 202 Affidavit of Personal Service of Papers — LUTZ APPELLATE PRINTERS, INC.

APPELLATE DIVISION
SECOND DEPARTMENT

UNITED STATES OF AMERICA and ROBERT RAGONE, Speacial Agent, Internal Revenue Service,
Petitioners-Appellees,

- against -

MANUFACTURES & TRADERS BANK, (formerly First Empire Bank-N.Y.) and JAMES A. KYPRIOS, Vice President, International Banking, Manufacturers & Traders Bank,
Respondents.,
ALLAN H. APPLESTEIN, Proposed Intervenor-Appellant

Index No.

Affidavit of Personal Service

On Appeal from the U.S. Dist. Court, So. Dist. of N.Y.

STATE OF NEW YORK, COUNTY OF NEW YORK *ss.:*

I, Reuben A. Shearer *being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at* 211 West 144th Street, New York, New York 10030

That on the 7th *day of* January *1977 at* 1 St. Andrews Plaza, New York, N.Y. 10007

deponent served the annexed Brief *upon* Mr. Robert Fiske, U.S. Attorney-So. Dist.

the *in this action by delivering a true copy thereof to said individual personally. Deponent knew the person so served to be the person mentioned and described in said papers as the* *herein,*

Sworn to before me, this 7th *day of* January, *19* 77

Robert T. Brin

ROBERT T. BRIN
NOTARY PUBLIC, State of New York
No. 31 0418950
Qualified in New York County
Commission Expires March 30, 1977

Reuben Shearer

Reuben Shearer